



MEMORANDUM

To: Members of the House Tax Policy Committee

From: Gilda Z. Jacobs, President and CEO

Date: January 17, 2018

Re: Michigan's Personal Exemption Fix - HB 5420

Thank you for the opportunity to express our concerns regarding House Bill 5420, which would clarify the status of, and increase, Michigan's personal and dependency exemptions on Michigan's state income tax return. While we support a clean retention of the personal exemption as the fairest option for all taxpayers, we oppose the increase because of budget pressures and uncertainty.

This bill is a result of consequences of changes made in the federal tax bill enacted at the end of 2017. Some leading economists, national think tanks, and even some of our own members of Congress argue that the federal tax bill was drafted in such a way to only impact the federal personal and dependency exemptions, not state exemptions that are tied to the amount of federal exemptions allowable. In fact, the tax bill merely reduces the amount of the exemption to \$0 and clearly states, "the reduction of the exemption amount to zero ... shall not be taken into account in determining whether a deduction is allowed or allowable, or whether a taxpayer is entitled to a deduction." The tax bill Conference Agreement itself characterizes this as a suspension of the deduction rather than a repeal or elimination. The state would not even be in this position if alternate interpretations were used.

However, we are grateful that the Administration and lawmakers are taking the opportunity to clarify the state law so that regardless of the interpretation used, Michigan residents do not lose their personal exemptions. Simply eliminating the personal exemption would make our tax code more regressive and would ultimately hurt families with low to moderate incomes hardest. A clean retention of Michigan's personal and dependency exemptions would maintain state taxes without having an adverse impact on our state budget.

We are also grateful that lawmakers chose the personal exemption as the method to "fix" the unintended consequence instead of a state income tax rate cut. Cutting the rate, while it could be revenue neutral to the state, would ultimately provide additional state tax cuts to wealthy Michigan taxpayers who just received large federal tax cuts while providing nothing or even raising taxes on those with low or middle incomes. In fact, most Michigan families would likely see a tax increase if the state income tax rate was cut instead of retaining the personal exemption. Finally, as stated above, the federal personal exemption is only temporarily suspended. If the state cut the rate now, when the exemptions are reinstated in 2026 we could find ourselves in a dire budget situation as our state exemptions would come back on the books.

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While we agree that, of the viable options on the table, the personal exemption is the best method to clarify the tax law, we are concerned with the amount of the increase in the exemption under this legislation and the resulting impact it could have on the state budget for several reasons.

- The revenue estimating conference shows that General Fund growth is essentially flat, but when you adjust for inflation, the purchasing power is less than it was in budget year 1968, when the state had fewer residents and fewer needs.
- We know we will have growing budget pressures—road funding, funding for healthcare, and the draw from the phaseout of the Personal Property Tax, including others—which will pull additional revenue away from the General Fund.
- Finally, we are concerned with the impact federal budget changes may have on our state. Lawmakers in Washington are already talking about making significant changes to programs many Michigan residents rely on, including food assistance, healthcare and basic public safety net programs. And as the deficit increases due to the federal tax bill, we could see additional cuts. As the state budget is about 40% federal funds, programmatic changes or changes in funding levels could significantly impact our state's ability to provide basic services.

We are concerned that there will be a tipping point where the tax benefits of the personal exemption increase will be outweighed by losses in social safety net programs, by the inaccessibility of healthcare services or mental health services, or by the worsening roads.

With so much uncertainty, we urge lawmakers to take a more modest approach—either simply restoring the exemptions or only increasing them slightly as the Governor has proposed—until we know what the potential impact is on our residents.

As an alternative, we do believe that a modest increase in the state Earned Income Tax Credit (EITC) is a less costly, more effective way to target tax cuts to those who really need it. The EITC is a sensible tool for helping Michigan's families keep working and make ends meet. The dollars from an increased state credit would flow right back into local economies and give Michigan businesses a boost. EITC also has a long-lasting positive impact on the lives of children, whose parents are better able to meet their needs. Research shows that children in working families getting EITC are more likely to perform better and go further in school and to work and earn more as adults.

Thank you for your time and consideration.